

United States House of Representatives  
Committee on Financial Services  
2129 Rayburn House Office Building  
Washington, D.C. 20515

April 12, 2021

## Memorandum

**To:** Members, Committee on Financial Services  
**From:** FSC Majority Staff  
**Subject:** April 15, 2021, Subcommittee on Consumer Protection and Financial Institutions Hearing entitled, “Banking Innovation or Regulation Evasion? Exploring Modern Trends in Financial Institution Charters”

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The Subcommittee on Consumer Protection and Financial Institutions will hold a hearing entitled, “Banking Innovation or Regulation Evasion? Exploring Modern Trends in Financial Institution Charters” on Thursday, April 15 at 10:00 a.m., on the virtual meeting platform Cisco Webex. This single-panel hearing will have the following witnesses:

- **Raúl Carrillo**, Deputy Director, LPE Project and Associate Research Scholar at Yale Law School
- **Erik Gerding**, Professor of Law, University of Colorado Law School
- **Kristin Johnson**, Asa Griggs Candler Professor of Law, Emory University School of Law
- **Carlos Pacheco**, CEO, Premier Members Credit Union on behalf of National Association of Federally-Insured Credit Unions (NAFCU)
- **Brian Brooks**, Former Acting Comptroller of the Currency

### Overview

Technology and related innovations are rapidly affecting the financial system, raising the potential to expand access to credit and other banking services while raising concerns regarding the adequacy of the current legal and regulatory framework governing these activities and market participants.<sup>1</sup> Traditionally, financial firms seeking to engage in the business of banking must apply for a bank or credit union charter from either state or federal banking regulators, in addition to applying for deposit or share insurance from the Federal Deposit Insurance Corporation (FDIC) or National Credit Union Administration (NCUA).<sup>2</sup> Once chartered and insured, financial institutions are subject to supervision and regulation, including consumer protection and prudential regulation promoting safety and soundness.<sup>3</sup> In recent years, the Office of the Comptroller of the Currency (OCC) and the FDIC have taken steps to allow firms to engage in banking activities while being subject to less regulations and supervision compared to most other banks and credit unions.<sup>4</sup> Additionally, some states have ventured into unconventional bank charters aimed at allowing cryptocurrency, blockchain, or other financial technology companies (fintech) to provide

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<sup>1</sup> See House Committee on Financial Services, [Virtual Hearing - License to Bank: Examining the Legal Framework Governing Who Can Lend and Process Payments in the Fintech Age](#) (Sep. 29, 2020).

<sup>2</sup> See Fed. [How Can I Start a Bank?](#) (Aug. 2, 2013); NCUA, [Share Insurance Fund Overview](#), (last modified Aug. 28, 2019).

<sup>3</sup> See CRS, [Bank Supervision by Federal Regulators: Overview and Policy Issues](#) (Dec. 28, 2020) (R46648).

<sup>4</sup> OCC, [OCC Begins Accepting National Bank Charter Applications From Financial Technology Companies](#) (Jul. 31, 2018); See also FDIC, [FDIC Approves the Deposit Insurance Application for Nelnet Bank, Salt Lake City, Utah Area](#) (Mar. 18, 2020); and

bank-like services.<sup>5</sup> At a time when risks to the financial system “remain elevated” during the COVID-19 pandemic,<sup>6</sup> ensuring there are adequate safeguards to promote financial stability, safety and soundness, consumer protection, and market fairness are important policy considerations with respect to banking charters and any related reforms to the legal and regulatory framework.

## Background

Oversight and supervision of financial institutions is shared across various regulators and generally is determined by whether the institution is chartered federally or by a state.<sup>7</sup> The National Currency Act of 1863 and National Bank Act of 1864 created the OCC and established a system of national banks with a goal, among other things, of standardizing a national currency.<sup>8</sup> While banks may still be chartered by state governments, the OCC has the sole ability to charter national banks. Additionally, national banks are required to join the Federal Reserve System (FRS).<sup>9</sup> The Board of Governors of the FRS (Fed) is the prudential regulator of state banks that are members of the FRS, and also the supervisor of bank holding companies, while the FDIC regulates state banks that are not members of the FRS. NCUA is the federal regulator for credit unions. Banks are subject to the Community Reinvestment Act and are able to export interest rates they charge that are allowable under their home state to borrowers in other states, even if those other jurisdictions have stricter usury laws.<sup>10</sup> Moreover, the FDIC provides deposit insurance to insured commercial banks, and the NCUA provides deposit insurance to most credit unions through the National Credit Union Share Insurance Fund. However, approximately two percent of credit unions are privately insured through a single company, American Share Insurance.<sup>11</sup> For depository institutions with more than \$10 billion in assets, the Consumer Financial Protection Bureau (CFPB) is the primary supervisor for consumer protection, and for such institutions with less than \$10 billion, the bank’s prudential regulator also supervises consumer compliance.<sup>12</sup> Furthermore, the CFPB has authority to supervise non-bank financial institutions though its authority over these institutions varies based on their activities and size.<sup>13</sup>

## Industrial Loan Companies

Industrial loan companies (ILCs) are state-chartered institutions similar to traditional commercial banks; they can originate loans, process payments, and take deposits insured by the FDIC.<sup>14</sup> While they are not allowed to offer checking accounts, ILCs often offer “negotiable order of withdraw” (NOW) accounts which are functionally equivalent to a checking account from a

<sup>5</sup> See Patrick Boot, [Wyoming Issues Second Crypto Bank Charter](#), National Law Review (Nov. 10, 2020); See also Tanzeel Akhtar, [Nebraska Lawmaker Introduces Bills That Would Permit Banks to Custody Crypto](#), Coindesk (Jan. 21, 2021).

<sup>6</sup> U.S. Department of Treasury, [FSOC 2020 Annual Report](#), at p. 3 (Dec. 3, 2020).

<sup>7</sup> See Figure 1 and 2 in appendix; Fed, [The Federal Reserve System: Purposes and Functions](#), at p. 77 (Oct. 2016).; CRS, [Bank Supervision by Federal Regulators: Overview and Policy Issues](#) (Dec. 28, 2020) (R46648).

<sup>8</sup> See OCC, [1863 – 1865 Founding of the National Banking System](#) (accessed Mar. 2021).

<sup>9</sup> See OCC, [Comptroller’s Licensing Manual](#), at p. 1-2 (Oct. 2019); See also CRS, [Federal Preemption in the Dual Banking System: An Overview and Issues for the 116th Congress](#) (May 17, 2019) (R45726).

<sup>10</sup> See CRS, [Federal Preemption in the Dual Banking System: An Overview and Issues for the 116th Congress](#) (May 17, 2019).

<sup>11</sup> NCUA, [Share Insurance Fund Overview](#) (last modified Aug. 28, 2019); GAO, [Private Deposit Insurance: Credit Unions Largely Complied with Disclosure Rules, but Rules Should Be Clarified](#) (Mar. 29, 2017) (GAO-17-259).

<sup>12</sup> *Id.*

<sup>13</sup> See CRS, [Introduction to Financial Services: The Consumer Financial Protection Bureau](#) (CFPB) (Jan. 4, 2021).

<sup>14</sup> See CRS, [Industrial Loan Companies \(ILCs\): Background and Policy Issues](#) (Updated Sept. 9, 2020) (R46489).

consumer's perspective.<sup>15</sup> First created in 1910 to lend to an underserved niche market of industrial workers, the popularity and uses of ILCs have varied significantly over the past century, as has how they have been regulated.<sup>16</sup> Currently, there are only 25 depository ILCs chartered by a handful of states including California, Hawaii, Minnesota, Nevada, and Utah.<sup>17</sup>

ILCs are regulated by both the state in which they are chartered and by the FDIC for compliance with requirements pertaining to safety and soundness, anti-money laundering and Bank Secrecy Act obligations, community reinvestment, and consumer protection.<sup>18</sup> A significant difference between ILCs and traditional banks is that unlike banks, ILCs that meet certain conditions (e.g. offering NOW accounts instead of demand deposit accounts) are not subject to supervision by the Fed under the Bank Holding Company Act (BHCA). Notably, entities subject to the BHCA are intentionally restricted from operating in commercial enterprises (nonfinancial activities like manufacturing or selling goods and services), a principle often referred to as the separation of commerce and banking.<sup>19</sup>

Proponents of ILCs argue that industrial banks are financially sound, and allowing companies to engage in both commerce and banking would create market efficiencies based on economies of scale and scope.<sup>20</sup> While no ILCs have failed in recent years, 13 ILCs failed between 1982 and 1984, and two ILCs engaged in subprime lending failed in 1999 and 2003.<sup>21</sup> Additionally, the Fed noted in a 2016 report to Congress that several companies that failed or required assistance during the financial crisis owned ILCs.<sup>22</sup> ILC opponents argue allowing banks to participate in commercial activities could expose the financial system to unnecessary risk, and may incentivize a bank to make decisions benefiting the non-financial subsidiary at the possible detriment to the safety and soundness of the bank.<sup>23</sup> Additionally, ILC opponents argue such a blend of financial and nonfinancial business could lead to monopolistic behavior in which companies without a financial institution subsidiary may find it more difficult to compete with ones that do. Such concerns were heavily debated when Walmart and Home Depot unsuccessfully pursued ILC charters in 2005 and 2006.<sup>24</sup> After receiving more than 13,000 public comment letters, the FDIC announced a moratorium on ILC deposit insurance in 2006 which was subsequently extended until 2008.<sup>25</sup> Congress adopted another moratorium in the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 which expired in 2013.<sup>26</sup> Even after the expiration of the statutory moratorium, the FDIC did not approve any ILC applications until March

<sup>15</sup> [12 C.F.R. §204.2\(b\)\(1\)](#); See also CFPB, [What is the difference between a checking account, a demand deposit account, and a NOW \(negotiable order of withdrawal\) account?](#) (Jan 23, 2017).

<sup>16</sup> See figure 3 in appendix; James Barth and Yanfei Sun, [A New Look at the Performance of Industrial Loan Companies and Their Contribution to the US Banking System](#), University of Utah, Utah Center for Financial Services, at p. 7-19 (Jan. 2018).

<sup>17</sup> FDIC, [Parent Companies of Industrial Banks and Industrial Loan Companies](#), (Feb. 23, 2021).

<sup>18</sup> *Id.*

<sup>19</sup> See John Krainer, [The Separation of Banking and Commerce](#), Federal Reserve Bank of San Francisco (Jul. 3, 1998).

<sup>20</sup> *Supra*, note 16.

<sup>21</sup> Arthur E. Wilmarth Jr. [The FDIC Should Not Allow Commercial Firms to Acquire Industrial Banks](#), George Washington University Law School (May 2020).

<sup>22</sup> *Id.*

<sup>23</sup> See Kenneth Spong and Eric Robbins, [Industrial Loan Companies: Growing Industry Sparks a Public Policy Debate](#), [Federal Reserve Bank of Kansas City](#), Economic Review, at p. 59-61 (2007).

<sup>24</sup> See Joe Adler, [Flashback When Walmart wanted a bank](#), *American Banker* (Aug. 23, 2017); Kevin K. Nolan, [Wal-Mart's Industrial Loan Company: The Risk to Community Banks](#), UNC School of Law, North Carolina Banking Institute (2006); See also *Supra*, note 14; Shaheen Pasha, [Coming Soon: A Walmart Bank?](#), *CNN Money* (Oct. 27, 2005).

<sup>25</sup> *Supra*, note 14.

<sup>26</sup> *Id.*

2020 when it granted deposit insurance to Square Financial and Nelnet Bank.<sup>27</sup> Several other companies have filed applications for ILC deposit insurance.<sup>28</sup> Additionally, the FDIC issued a final rule on the process and safety and soundness requirements for ILC deposit insurance applications on December 15, 2020.<sup>29</sup> The recent activity around ILCs has renewed public interest and scrutiny in ILC charters, with some stakeholders calling for a three year moratorium on approving ILC applications while Congress considers changes to the legal framework.<sup>30</sup>

### **OCC Special Purpose National Bank Charters for Fintech Companies**

On December 16, 2016, the OCC published a white paper and solicited public comments concerning the OCC offering Special Purpose National Bank Charters (SPNBs) for fintech companies, including companies offering digital payments, consumer loans, crowdfunding, and other web-based financial services.<sup>31</sup> In July 2018, after receiving public comments and issuing a draft supplement to the national bank licensing manual, the OCC announced it was finalizing the supplement to the licensing manual and would begin accepting applications from fintech companies seeking SPNBs.<sup>32</sup> The New York State Department of Financial Services sued the OCC, challenging the agency's ability to issue national charters to fintechs using authority under the National Bank Act.<sup>33</sup> The U.S. District Court for the Southern District of New York held that the OCC had exceeded its authority by extending the charter to non-depository institutions, and ordered the OCC to halt approving any SPNB applications for a fintech company that does not accept deposits.<sup>34</sup> The OCC is appealing the decision.<sup>35</sup>

### **OCC Payments Charter and National Trust Banks**

Under current law, nonbank money transmitters and payment processors are mostly regulated at the state level.<sup>36</sup> Some critics of the current model have argued a state-by-state regulatory regime is not well equipped to manage this system, and have suggested the federal government could play a larger role.<sup>37</sup> Former OCC Acting Comptroller Brian Brooks sought to create a national payments charter after the OCC's ability to issue SPNBs was ordered to be halted by the courts.<sup>38</sup> There is little documentation of this effort as Mr. Brooks believed that the OCC "[did not] need a new regulation or a new statute on it."<sup>39</sup> Additionally, Acting Comptroller Brooks indicated cryptocurrency companies and payment processors could also pursue a national

<sup>27</sup> FDIC, [FDIC Approves the Deposit Insurance Application for Nelnet Bank, Salt Lake City, Utah Area](#) (Mar. 18, 2020); FDIC, [FDIC Approves the Deposit Insurance Application for Square Financial Services, Inc., Salt Lake City, Utah](#) (Mar. 18, 2020).

<sup>28</sup> Supra, note 14.

<sup>29</sup> The Dodd-Frank Wall Street Reform and Consumer Protection Act required the FDIC to mandate parent companies of ILCs to "serve as a source of financial strength" to the depository institution; [12 U.S.C. §1831o-1\(b\)](#); FDIC, [FDIC Approves Rule to Ensure Safety and Soundness of Industrial Banks](#) (Dec. 15, 2020).

<sup>30</sup> See ICBA, [Consumer, Civil Rights Groups & Industry Urge FDIC: Halt Approval of Industrial Bank Applications, Close ILC Loopholes First](#) (Mar. 16, 2020); BPI, [Banking and Consumer Groups Call on Congress to Close ILC Loophole](#) (Jul. 29, 2020); See also Committee, [Waters Calls on FDIC to Hold Public Hearing on SoFi's Application for Bank Charter](#) (Aug. 25, 2017).

<sup>31</sup> OCC, [Exploring Special Purpose National Bank Charters for Fintech Companies](#) (Dec. 2016).

<sup>32</sup> OCC, [OCC Begins Accepting National Bank Charter Applications From Financial Technology Companies](#) (July 31, 2018).

<sup>33</sup> The Conference of State Bank Supervisors also sued the OCC in the U.S. District Court for the District of Columbia, but the case was dismissed; See CRS, [Court Battle for Fintech Bank Charters to Continue](#) (Dec. 2019) (LSB10381).

<sup>34</sup> [Linda A. Lacewell v. Office of the Comptroller of the Currency](#) (S.D.N.Y. 2019).

<sup>35</sup> Notice of Appeal, [Lacewell v. OCC](#), No. 1:18-cv-08377 (S.D.N.Y. Dec. 19, 2019).

<sup>36</sup> See CRS, [U.S. Payment System Policy Issues: Faster Payments and Innovation](#) (Sept. 23, 2019) (R45927).

<sup>37</sup> OCC, [OCC Summary of Comments and Explanatory Statement: Special Purpose National Bank Charters for Financial Technology Companies](#) (Mar. 2017); See also Benjamin Lo, [Fatal Fragments: The Effect of Money Transmission Regulation on Payments Innovation](#), Yale Journal of Law and Technology (2017).

<sup>38</sup> Forbes, [OCC Chief Brian Brooks Says Payments Charter Is Ready, More Crypto Banks Coming Soon](#), (Nov. 17, 2020).

<sup>39</sup> Politico, [Top regulator pushes ahead with plan to reshape banking, sparking clash with states](#), (Aug. 31, 2020).

trust charter, and on January 13, 2021, the OCC granted conditional approval for Anchorage Trust Company’s application to become a national trust bank.<sup>40</sup> Anchorage offers custody and settlement services for cryptocurrencies.<sup>41</sup>

### State Charters and Licenses for Cryptocurrency and Blockchain Firms

In recent years, various states have initiated new licenses and banking charters focused on cryptocurrency and blockchain companies. For example, in 2015, the State of New York debuted a “BitLicense,” to regulate persons or companies involved in virtual currency business activity.<sup>42</sup> In 2019, the State of Wyoming enacted a series of laws, including one authorizing the chartering of special purpose depository institutions (SPDIs). These financial institutions may “receive deposits and conduct other incidental activities, including fiduciary asset management, custody and related activities.”<sup>43</sup> SPDIs would operate similar to a custodian bank, offering services such as “storing assets, fiduciary management, conducting a variety of transactions with assets and providing an ‘on/off’ ramp to securities markets, commodities markets and customer bank accounts.”<sup>44</sup> In September 2020, Wyoming approved the first SPDI application for Kraken Bank, a digital asset company based in Cheyenne, Wyoming.<sup>45</sup> Kraken’s stated purpose of establishing the bank is to form a connection between cryptocurrency and the traditional financial system.<sup>46</sup> However, unlike traditional banks, Kraken deposits will not be insured by the FDIC, and instead the bank will be required to maintain 100 percent reserves of deposits in fiat currency and “liquid assets.”<sup>47</sup> Some critics have noted that depending on how the bank invests the reserves, the plan could be problematic to the safety and soundness to the institution under stress.<sup>48</sup> Notably, other state legislatures are considering similar legislation that would allow for either existing banks or *de novo* institutions to handle and process transactions for digital assets more easily.<sup>49</sup>

### Legislation

- **H.R. \_\_\_\_\_, Banking Charter Review Act**, which would impose a three-year moratorium on the FDIC’s ability to approve ILC applications for deposit insurance and most change of control requests by entities seeking to acquire an existing ILC. It would also require a Government Accountability Office (GAO) study analyzing various federal and state banking charters as well as the use of technology by market participants, and provide administrative and legislative recommendations to promote the separation of banking and commerce, consumer protection, diversity and inclusion, safety and soundness, financial stability, and fair competition for current and potential market participants.
- **H.R. \_\_\_\_\_, Close the ILC Loophole Act (C. Garcia)**, which would eliminate an exemption to the Bank Holding Company Act that permits ILCs and their corporate owners

<sup>40</sup> OCC, [OCC Conditionally Approves Conversion of Anchorage Digital Bank](#) (Jan. 13, 2021).

<sup>41</sup> Anchorage Digital Bank National Association, [About](#) (accessed Apr. 1, 2021).

<sup>42</sup> New York State Department of Financial Services, [BitLicense FAQs](#) (accessed Apr. 1, 2021); and CoinDesk, [BitLicense at 5: A Timeline of New York’s Landmark Cryptocurrency Regulation](#) (Jun. 24, 2020)

<sup>43</sup> Wyoming Banking Division, [Special Purpose Depository Institutions](#) (accessed Apr. 1, 2021); Gregory Barber, [The Newest Haven for Cryptocurrency Companies? Wyoming](#), Wired (June 13, 2019); and Jacob Rozen, [Wyoming wants to attract crypto firms with blockchain-friendly laws](#) Coin Desk (Nov. 24, 2019).

<sup>44</sup> Wyoming Banking Division, [Special Purpose Depository Institutions](#) (accessed Apr. 1, 2021).

<sup>45</sup> See KrakenFX, [Kraken Wins Bank Charter Approval](#), Kraken (Sept. 16, 2020).

<sup>46</sup> *Id.*

<sup>47</sup> Wyoming Statute, [13-12-105](#), (Feb. 26, 2019).

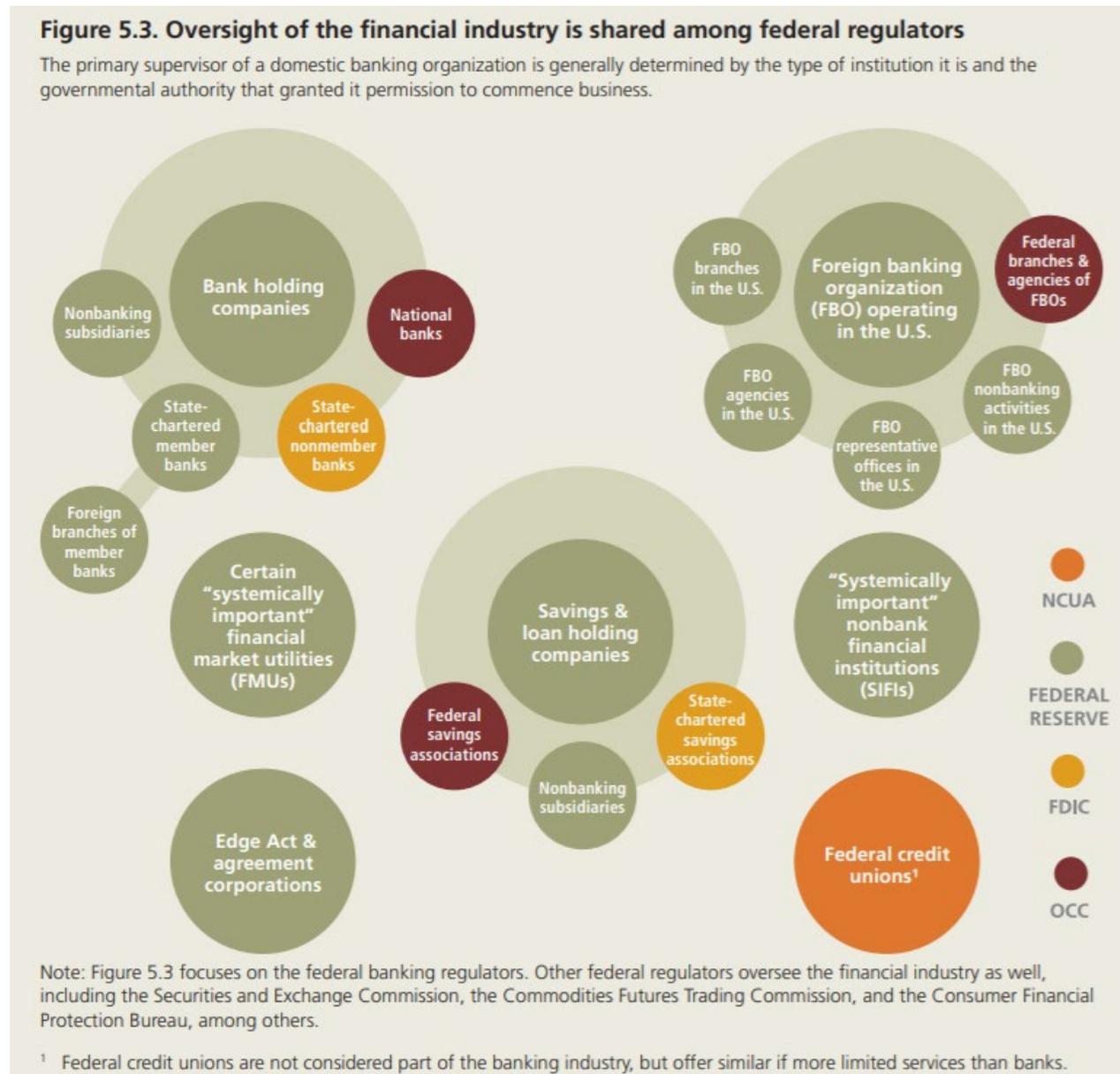
<sup>48</sup> See Bank Policy Institute Staff, [Beware the Kraken](#), BPI (Oct. 21, 2020).

<sup>49</sup> See Coin Telegraph, [Nebraska senator introduces bills to allow state banks to custody crypto](#) (Jan. 21, 2021).

to operate outside of that law's regulatory framework, including consolidated supervision and activity restrictions, unlike other banks.

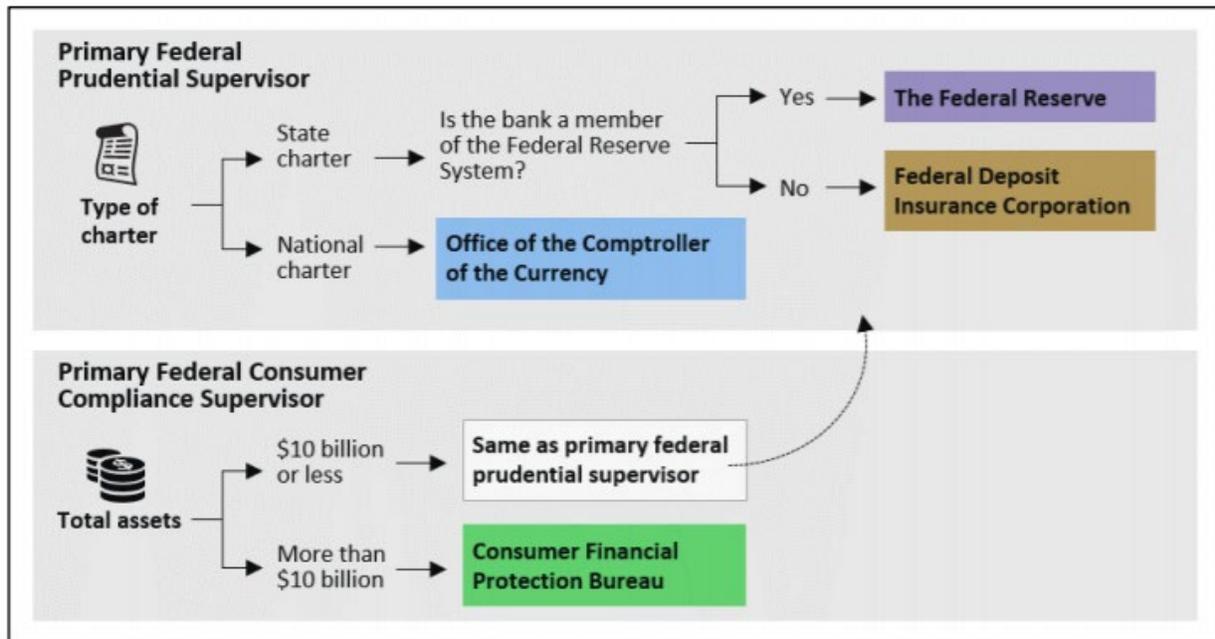
## Appendix

### Figure 1. Federal Banking Regulatory Oversight



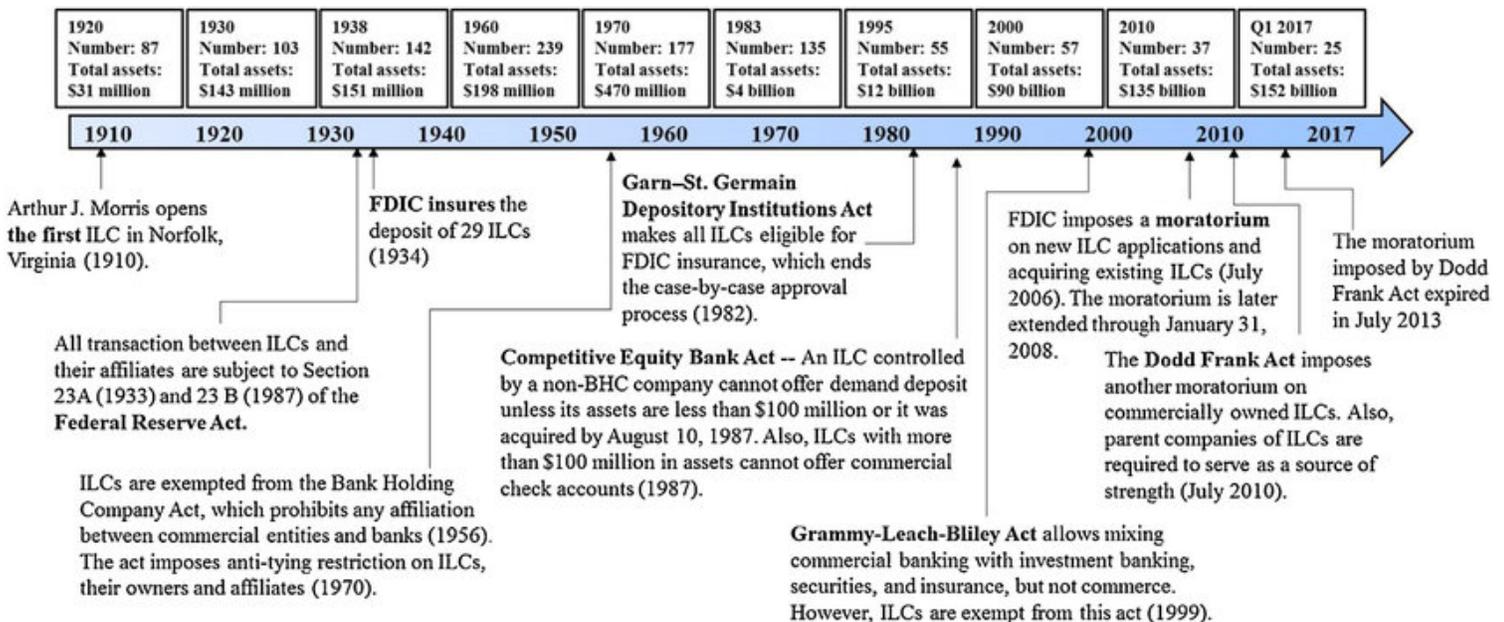
Source: Fed, [The Federal Reserve System: Purposes and Functions](#), Tenth Edition, Oct. 2016, p.77

Figure 2. Primary Federal Prudential and Consumer Protection Supervisor



Source: CRS, [Bank Supervision by Federal Regulators: Overview and Policy Issues](#); R46648, (Dec. 28, 2020)

Figure 3. Evolution of the Industrial Loan Companies (ILCs)



Source: Barth, James and Yanfei Sun, "[A New Look at the Performance of Industrial Loan Companies and Their Contribution to the US Banking System](#)", University of Utah, Utah Center for Financial Services, Jan. 2018.